

Robert Bates on Omar Azfar's "The NIE Approach to Economic Development: An Analytic Primer"

In "The NIE Approach to Economic Development," Omar Azfar provides a capable and comprehensive overview of what has in short order become a *very* large field. This overview provides both an opportunity and a challenge. The opportunity is to capture the outlines of the forest within which grow the numerous trees depicted by Azfar; the opportunity is to pen yet another topic into the agenda of the field.

Azfar employs Williamson's "hierarchy" as a way of organizing the diverse strands that go into the new institutional economics. When he does so, I am reminded of the discomfort I experienced when first encountering Williamson's initial exposition. At best, we are left with is an exhortation – "economists, be broad in your conception of the field." Perhaps because I am not an economist, I remain underwhelmed. But even more unsettling is the realization of how imprecise the conceptualization is. It is extremely imprecise.

That Azfar reaches for the Williamson's formulation is suggestive, I would venture, in that it possibly provides an important insight into why "The New Institutionalism" has found such widespread appeal within the development community. Quite apart from its intellectual merits, the approach is a house of many chambers; in particular, it provides a "portmanteau" within which non-economists can reside with economists, and claim that they too belong. If the new paradigm for economics ventures into terrain traditionally inhabited by psychologists, anthropologists, sociologists and historians, then surely the members of those disciplines must have something important to say about the determinants of development. Given that in some circles the sun does not shine until an economist proclaims the arrival of dawn, this form of economics legitimates members of other disciplines and lends credibility to their insights into the development process.

That said, my primary reaction is that I find the Williamson's conception far too broad to be useful and would substitute an alternative conception of the structure of this field. With a total lack of imagination or originality, I would classify contributions into two categories: Those that are macro- and those that are micro- in orientation.

"The New Institutionalism" operates powerfully at the micro-level. It has provided incisive insights into the structure of firms, the organization of industries, and the nature of contracts. One cannot understand financial markets without having absorbed the work of its leading practitioners. One cannot understand insurance. Nor can one study the formation of human capital, the operation of labor markets, or the behavior of the firm. Within micro-economics, "The New Institutionalism" has triumphed.

One reaction to this observation is simply to note it and to turn to the more problematic portion of the field. That is what I shall shortly do. Another is to note in passing an implication that provides further reason for the conversion to "The New Institutionalism." Having for the last several decades focused on macro-level features of the economy – the exchange rate, the interest rate, adjustment to macro-level shocks, and so on –

development specialists have begun to highlight the significance of micro-level features of the economy. Macro-level policies have proved not to be sufficient to spark growth and development. The economic response to macro-level reforms appears to have been blunted by deficiencies in financial institutions, legal safeguards, and the regulatory environment. The new institutionalism stands triumphant within micro-economics; and the turn to the micro-level in development assistance programs requires that its contribution be confronted and absorbed by the development community.

What of the contributions of the new institutionalists at the macro-level? Should we accept the portrait of the field as set out by Azfar, I would have to argue that by comparison with the output at the micro-level, much less has been accomplished. There is much suggestive work, but little that is deeply convincing. Either, as in the work of say Douglass North, the arguments have yet to be tested systematically; or, as in the work of Shleifer and associates, while tested, the arguments have yet to be modeled, such that we gain a convincing account of the causal processes that generate the regularities that they observe and report. This record is thus far spottier, then, than what we observe in the fields of education, labor, and so forth.

There, the record of “The New Institutionalism” appears far stronger, however, if we abandon Azfar (and Williamson’s) portrayal of the field and name the field of political economy as the macro-level counterpart to the micro-level work in this field. In recent years, the field of political economy has become an established sub-field in economics.<sup>1</sup> Formal models are now well developed for elections, legislatures, interest groups, and bureaucracies. Some are well tested. The well-known Ferejohn model<sup>2</sup>, for example, has been well tested on both African and global data and underscored the importance of competitive elections for macro-economic stability.<sup>3</sup>

Another reason for inserting politics into the macro-level of the “New Institutionalism” is that, without it, the literature at the micro-level remains incomplete.

To caricature a typical argument in the field, economic agents meet, they encounter “transaction costs” which limits their capacity to reap mutually beneficial gains. In response, they innovate an institution – be it a legal system, a governance structure (i.e. a firm), or what not—to reduce them. Characteristic of institutions is that introduce coercion into economic life; in institutional settings, agents anticipate penalties should

<sup>1</sup> See, for example, Drazen, A. (2000). *Political Economy*. Princeton, Princeton University Press., Laffont, J.-J. (2000). *Incentives in Political Economy*. Oxford, Oxford University Press. Persson, T. and G. Tabellini (2000). *Political Economics: Explaining Economic Policy*. Cambridge, MIT Press. Grossman, G. M. and E. Helpman (2001). *Special Interest Politics*. Cambridge MA, The MIT Press.

<sup>2</sup> Ferejohn, J. (1986). “Incumbent Performance and Electoral Control.” *Public Choice* **50**: 5-26.

<sup>3</sup> Humphries, M. and R. H. Bates (2001). *Political Institutions and Economic Policies*.

they behave opportunistically, and so forgo socially costly actions that previously had been attractive. Thus the rub. Where does the power to coerce come from? The answer is that it is supplied to economic agents, or withheld from them, by politicians. The micro-level accounts of the new institutionalists are thus partial. For their completion they require that an account be taken of the political system and of its readiness to delegate authority to economic agents such that they can operate more profitably.

## References

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